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IN THE

Supreme Court of the United States

October Term, 1974

Estate of DAVID SMITH, Deceased,
IRA M. LOWE, CLEMENT GREENBERG,
ROBERT MOTHERWELL, Co-executors,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

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No. .....

Estate of DAVID SMITH, Deceased,
IRA M. LOWE, CLEMENT GREENBERG, ROBERT MOTHERWELL,
Co-executors,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.

Opinions Below

The findings of fact and opinion of the United States Tax Court (Tannenwald, *Judge*), were filed on February 23, 1972 and are reported at 57 T.C. 650. Five judges dissented with respect to the issue which is the subject of this petition. The opinions are printed as Appendix A to this petition.

The majority opinion of the United States Court of Appeals for the Second Circuit (Kaufman, *Chief Judge* and Anderson, *Circuit Judge*), affirming the Tax Court on the issue which is the subject of this petition, and the dissenting opinion (Mulligan, *Circuit Judge*), were filed on February 4, 1975 and are reported at 510 F.2d 479 and 75-1 U.S. Tax Cas. ¶13,046. The opinions are printed as Appendix B to this petition.

Jurisdiction

The judgment of the United States Court of Appeals for the Second Circuit was entered on February 4, 1975. Jurisdiction is conferred on this Court by 28 U.S.C. §1254(1).

Questions Presented

1. Whether section 2053(a) of the Internal Revenue Code of 1954[1] permits the Commissioner of Internal Revenue (hereinafter, the "Commissioner") to apply a Federal

1. All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

standard of "necessity" in determining whether expenses incurred in selling estate property that are allowable administration expenses under state law are deductible for Federal estate tax purposes.

2. Whether the Federal estate tax deduction under section 2053(a) and the Treasury Regulations thereunder for expenses incurred in selling estate property was properly limited by the Tax Court and the Court of Appeals to the exact amount necessary to raise cash to meet other administration expenses, debts and finally adjudicated tax deficiencies, when the full sales expenses are allowable under state law as proper administration expenses and were allowed as such by the state probate court having jurisdiction over the estate.

Statute Involved

The statute involved is section 2053(a) of the Internal Revenue Code of 1954, as amended. It is printed as Appendix C to this petition, together with the pertinent Treasury Regulations adopted thereunder.

Statement of the Case

David Smith, a sculptor, died on May 23, 1965 possessed of liquid assets worth $210,647.08 and 425 pieces of his own sculpture (B, 31a).[2] His Will was admitted to probate by the Surrogate's Court of Warren County, New York, and

2. "A" references are to the findings of fact and opinions of the Tax Court, printed as Appendix A hereto. "B" references are to the opinions of the United States Court of Appeals for the Second Circuit, printed as Appendix B hereto.

Ira M. Lowe, Clement Greenberg, and Robert Motherwell were duly appointed and qualified as co-executors of the estate (hereinafter, the "Executors" and the "Estate").

Smith began sculpting in 1937. Most of his work is abstract, nonrepresentational art fashioned out of welded steel and other metals. While Smith had begun to gain critical recognition in his later years, he had never been commercially successful (A, 5a). During the last 25 years of his life Smith sold only 75 pieces of his sculpture, for a total consideration of $218,080.50 (A, 2a to 5a).

On June 2, 1963, Smith entered into an agreement with the Marlborough-Gerson Gallery Inc. (hereinafter the "Gallery") which gave it the exclusive right to sell his work for a period of five years and entitled it to a commission of ⅓ of the net proceeds from any piece of sculpture sold (A, 3a to 4a). Between June 2, 1963 and Smith's death, the Gallery's efforts resulted in a total of five sales of sculpture (A, 5a).

At his death Smith retained far more of his sculpture than he had sold during his entire lifetime. The existence of this mass of unsold sculpture was not generally known and had the Executors attempted a bulk sale of the sculpture held by the Estate they would have received substantially less than could be received by feeding the sculpture slowly into the market over a period of time (A, 7a).

Shortly after Smith's death, the Executors began a gradual liquidation of the Estate's holdings of sculpture through the Gallery. From May 23, 1965 through August

21, 1973, an aggregate of $1,602,644.67[3] in sales commissions was paid the Gallery and properly allowed as administration expenses by the Surrogate's Court of Warren County, New York (B, 32a).

A Federal estate tax return was filed on August 24, 1966 and an initial deficiency was agreed upon and paid by the Executors on July 10, 1968. On August 7, 1969, the Commissioner issued a notice of deficiency for an additional $2,444,629.17 of estate taxes, based upon a substantial increase in the valuation of Smith's sculpture, to $5,256,918.

Upon a petition by the Executors for redetermination under section 6213, the Tax Court valued the sculpture at $2,700,000, and no appeal was taken from this valuation. Of the total of $1,602,644.67 in commissions paid by the Executors to the Gallery during the administration of the Estate, the Tax Court allowed the Estate only $750,447.74 as a deduction for sales commissions under section 2053(a) and Treasury Regulations §20.2053-3(d)(2). This amount of commissions was the exact amount necessary to raise cash for payment of the decedent's debts, the other expenses of administration, and taxes as finally adjudicated by the Tax Court (B, 32a to 33a). Five judges would have allowed a deduction for the full amount of sales commissions approved by the state court (A, 22a to 29a). The Estate took an appeal to the Court of Appeals on this issue. The Court of Appeals affirmed the Tax Court's decision, Judge Mulligan dissenting (Appendix B).

3. There is a minor inconsistency in the Record as to whether the total commissions approved by the Surrogate's Court were $1,602,644.67 or $1,583,544.67.

Reasons for Granting the Petition

This Federal estate tax case warrants review by this Court for two reasons:

First, the decision of the Court of Appeals has unsettled a question important to the administration of the Federal estate tax law and to the administration of decedents' estates generally which has not been, but now should be, settled by this Court, namely whether the Treasury Regulations can impose a new and additional standard for deductibility of a claimed administration expense beyond the requirement of section 2053(a) that the expense be allowable under state law.

Second, the decision of the Court of Appeals is in direct conflict with the decision of the United States Court of Appeals for the Sixth Circuit in *Estate of Park* v. *Commissioner,* 475 F.2d 673 (1973), which explicitly rejected the decision of the Tax Court in this case, and also conflicts with other decisions of the United States Courts of Appeals for the Fourth and Seventh Circuits.

I

The decision of the Court of Appeals has unsettled a question important to the administration of the Federal estate tax law and to the administration of decedents' estates generally which has not been, but now should be, settled by this Court, namely whether the Treasury Regulations can impose a new and additional standard for deductibility of a claimed administration expense beyond the requirement of section 2053(a) that the expense be allowable under state law.

The Court of Appeals affirmed the decision of the Tax Court, which allowed a deduction for only a portion of the sales commissions paid the Gallery, on the basis that the Tax Court had made a valid "*de novo* inquiry into the factual necessity" of the sales (B, 37a). The Court of Appeals would sustain this inquiry by the Tax Court despite the fact that the full sales commissions were allowable administration expenses under state law and in fact had been allowed by the New York Surrogate's Court as administration expenses in five separate accounting proceedings brought by the Executors.

The decision of the Court of Appeals is wrong for two fundamental reasons. First, it ignores the clear command of section 2053(a), which states that for Federal estate tax purposes an executor is entitled to deduct from the gross estate such "administration expenses . . . as are allowable by the laws of the jurisdiction . . . under which the estate is being administered." Second, it ignores the fact that the Tax Court never examined state law in this proceeding, but instead imposed its own substantive Federal standard for deductibility of administration expenses.

The Court of Appeals in its majority opinion ignored the Code and focused instead upon Treasury Regulations §20.2053-3(d)(2) (reproduced at C, 44a), which provides a deduction from the gross estate for selling expenses only "if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate or to effect distribution." The Court of Appeals' decision, conflicting as it does with that of the New York Surrogate's Court, is based on the premise that the interest of the Federal government in collecting taxes may be different from that of the state court supervising the administration of the estate. But if there is any such difference, as Judge Mulligan clearly states in his dissent, Congress in drafting section 2053(a) "decided without any limitation that the state law controlled" in determining the deductibility of estate administration expenses (B, 39a).

The Court of Appeals is also wrong in asserting that the Tax Court was making a *de novo* inquiry into the facts, and not refusing to follow New York law. Judge Tannenwald explicitly so refused. He states,

> "The mere fact that the commissions claimed by petitioner herein to be deductible were allowed by the New York Surrogate's Court is not sufficient. The clause 'as are allowable by the laws of the jurisdiction * * * under which the estate is being administered,' contained in section 2053(a), establishes a threshold and not an exclusive condition; the requirements of respondent's regulations must also be satisfied." (A, 19a)

There is no evidence of an inquiry into New York law in Judge Tannenwald's opinion for the majority of the Tax

Court. The Tax Court conceded that the expenses had been allowed by the New York Surrogate's Court and did not suggest that the state court had acted improperly in doing so. The Tax Court instead limited the deduction because of its belief that allowance of a full deduction for the commissions would "seriously undermine" the objectives of the Treasury Regulations (A, 21a).

Judge Tannenwald read the Treasury Regulations as imposing an additional limitation on the deductibility of an administration expense beyond the sole requirement imposed by Congress in section 2053(a), that the expense be allowable under state law. Five Tax Court judges dissented because of this interpretation of the Regulations (A, 27a to 28a).

It is because of factual situations such as that involved in this estate that Congress left to state law the determination of the allowability of estate expenses. Approximately 93% of the value of Smith's total estate consisted of his own unsold sculpture. Many of these works of welded steel weighed several tons and almost half were over seven feet tall. Faced with these assets and the necessity of paying estate taxes in an amount which could not be determined until the conclusion of the dispute with the Commissioner over the value of the sculpture, and uncertain of their ability to raise cash to meet the Estate's obligations due to the volatile nature of artistic fashions and Smith's inability to sell his art work during his lifetime, the Executors began a program of sculpture sales, thereby incurring the selling commissions in issue.

The New York Surrogate's Court reviewed these sales in five different accountings, determined that they were proper, and allowed the resulting sales commissions as administration expenses under New York law. The New York Surrogate's Court, like most other probate courts, determines every day the necessity of fiduciary expenditures. That is its function, and Congress recognized this in leaving to "the laws of the jurisdiction . . . under which the estate is being administered" the determination of proper administration expenses.

In the face of that statutory mandate, the Tax Court here ignored the proceedings in the New York Surrogate's Court and functioned as a "surrogate Surrogate" (B, 40a). In a decision rendered long after most of the sales had taken place, the Tax Court determined that the only deductible expenses were those in the precise dollar amount which retrospect shows to have been "necessary" to raise cash needed to meet the taxes and administration expenses payable under the Tax Court's *own decision.*

This Court has not defined the standard by which the deduction for administration expenses properly allowable under state law will be disallowed under Federal law. The United States Courts of Appeals for the Fourth, Sixth and Seventh Circuits in *Commercial Nat. Bank of Charlotte* v. *United States,* 196 F.2d 182 (4th Cir. 1952), *Estate of Park* v. *Commissioner,* 475 F.2d 673 (6th Cir. 1973), *Union Commerce Bank* v. *Commissioner,* 339 F.2d 163 (6th Cir. 1964), and *Ballance* v. *United States,* 347 F.2d 419 (7th Cir. 1965), have all squarely held that an expense properly allowed by the state court is deductible under section 2053. The prior decisions of the Tax Court in *Estate of Louis Sternberger,* 18 T.C. 836 (1952), *aff'd* 207 F.2d

600 (2d Cir. 1953)[4], *reversed on other grounds,* 348 U.S. 187 (1955) and of the United States Court of Appeals for the Second Circuit in *Dulles* v. *Johnson,* 273 F.2d 362 (2d Cir. 1959), *cert. den.,* 364 U.S. 834 (1960), have supported this view.

The decision of the Court of Appeals in this case has thus created uncertainty in an area of substantial importance to the administration of the Federal estate tax laws and the administration of decedents' estates generally, and only a decision by this Court can resolve that uncertainty.

II

The decision below is in direct conflict with the decision of the United States Court of Appeals for the Sixth Circuit in *Estate of Park* v. *Commissioner,* 475 F.2d 673 (1973), which explicitly rejected the decision of the Tax Court in this case, and also conflicts with other decisions of the United States Courts of Appeals for the Fourth and Seventh Circuits.

In this case, for the first time in the Second Circuit, the Court of Appeals held that expenses incurred in selling estate assets, which were allowable under state law and properly allowed by the state court supervising the administration of the estate, were nevertheless not deductible administration expenses under section 2053(a). The United States Court of Appeals for the Sixth Circuit, which had before it the opinions of the Tax Court in this case, has ruled squarely to the contrary in *Estate of Park* v. *Commissioner,* 475 F.2d 673 (1973), stating,

4. The issue of deductibility of selling expenses was not appealed.

> "By the literal language of §2053(a), Congress has left the deductibility of administrative expenses to be governed by their chargeability against the assets of the estate under state law. As otherwise stated, Congress has committed to the considered judgment of the states whether a particular expense is allowable as a proper or necessary charge against estate assets. In the situation before us, the expenses were admittedly allowable under Michigan law. They were paid out of probate assets and they were approved in two different accountings filed with the probate court. Hence they are deductible under §2053(a)." 475 F.2d at 676.

The taxpayer in the *Park* case relied primarily in the Sixth Circuit on the dissent filed in the Tax Court in *Smith*. The Commissioner relied on the majority's approach. After examining Judge Tannenwald's majority opinion on this issue in detail, the Court of Appeals for the Sixth Circuit rejected his reasoning as "unpersuasive", reversed the Tax Court in the case before it, and held that "the deductibility of an expense under 2053(a) . . . is governed by state law alone". 475 F.2d at 676.

The decisions of the Second Circuit, in this case, and of the Sixth Circuit, in *Park*, are therefore in direct conflict in their interpretation of section 2053(a) and of the meaning and validity of the Treasury Regulations issued thereunder. Moreover, the Sixth Circuit has examined in detail and rejected the majority opinion of the Tax Court in this case. Such a conflict between two courts of appeals on precisely the same question should be resolved by this Court.

Furthermore, as Judge Mulligan points out in his dissent below, the Sixth Circuit is not alone in its enforce-

ment of section 2053(a) in accordance with its clear terms. The Seventh Circuit, in *Ballance* v. *United States*, 347 F.2d 419 (7th Cir. 1965), and the Fourth Circuit, in *Commercial Nat. Bank of Charlotte* v. *United States*, 196 F.2d 182 (4th Cir. 1952), have interpreted section 2053(a) in the same way (B, 38a).

In *Ballance* v. *United States*, *supra*, the Seventh Circuit recognized that the determination of the deductibility of an expenditure must be based on what under local law "properly constitutes an allowable expense of administration", and stated that "the definition of 'administration expenses' in the treasury regulation as such expenses as are 'necessarily' incurred in the administration of the estate cannot serve to override the statutory provision (Section 812) authorizing the deduction of '[s]uch amounts * * * for administration expenses * * * as are allowed by the laws of the jurisdiction * * * under which the estate is being administered'." 347 F.2d at 423.

The Fourth Circuit, in *Commercial Nat. Bank of Charlotte* v. *United States*, *supra*, stated that "it would seem to have been the purpose of Congress to follow the state law in the allowance for administration expenses." 196 F.2d at 185. The expenses in that case were held not to be deductible because *under state law* the amounts were not treated as costs of the suit borne by the executors, but rather as costs of the individual beneficiaries.

The substantial weight of authority is thus in conflict with the decision of the Court of Appeals here. The Court of Appeals states that it can and does affirm the Tax Court without passing on "whether Treas. Reg. §20.2053-3(d)(2)

is invalid if read to deny a deduction properly allowed by state law'' (B, 37a), but neither the majority nor the dissent in the Tax Court below, nor Judge Mulligan in the Court of Appeals below, nor the Sixth Circuit in the *Park* case, found it possible to reach the result reached in this case without dependence on Treasury Regulations §20.2053-3(d)(2). In affirming the Tax Court, the Court of Appeals has passed on the Treasury Regulations and has reached a decision directly contrary to that in *Park*. The conflict can only be resolved by this Court.

Conclusion

The petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

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May 5, 1975

APPENDICES

APPENDIX A

Findings of Fact and Opinion of Tax Court, Together With Concurring and Dissenting Opinions, February 23, 1972

ESTATE OF DAVID SMITH, Deceased, *et al.*,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 4251—69, Filed February 23, 1972

UNITED STATES TAX COURT

IRA M. LOWE, *for the Petitioner*

ST. CLAIR REEVES, *for the Respondent*

TANNENWALD, *Judge*: Respondent determined a deficiency of $2,444,629.17 in the Federal estate tax of the Estate of David Smith (hereinafter referred to as Smith or decedent).

Several issues raised in the petition have been either resolved by agreement of the parties or abandoned by petitioner. The following issues remain for decision: (1) The fair market value of 425 sculptures created by Smith and in his possession at the time of his death; and (2) the deductibility of certain commissions incurred and paid by petitioner in the course of selling some of the aforementioned sculptures.

Appendix A—Findings of Fact and Opinion of Tax Court

FINDINGS OF FACT

Some of the facts have been stipulated and, together with the exhibits attached thereto, are incorporated herein by this reference.

David Smith died from injuries sustained in an automobile accident on May 23, 1965. He was a citizen of the United States and a resident of Bolton Landing, N.Y., at the time of his death. Robert Motherwell, Clement Greenberg, and Ira M. Lowe qualified as coexecutors of the decedent's estate. A Federal estate tax return was filed on August 24, 1966, with the district director of internal revenue in Albany, N.Y.; the property included therein was valued as of the date of decedent's death. A deficiency was agreed upon and paid on July 10, 1968. On August 7, 1969, respondent issued the notice of deficiency herein.

At his death, Smith owned 425 pieces of sculpture created during various periods of his life. Of these sculptures, 291 were located at Bolton Landing, N.Y.

Smith began making metal sculptures in 1937. Most of his work is of the abstract, nonrepresentational variety and fashioned out of welded steel and other metals, a technique which Smith pioneered. The quality of Smith's sculptures varied according to the period in his life during which they were created. From 1940 to 1963, Smith was represented by two art galleries who endeavored to sell his works, albeit without much success. Between 1940 and 1956, Smith was represented by the Willard Gallery, during which time 53 of his works were sold for $33,432.50 at prices ranging from $40 to $3,213. From 1957 until 1963, he was repre-

sented by the Otto Gerson Gallery, during which time 17 pieces were sold for $76,148.

On or about June 2, 1963, Smith and Marlborough-Gerson Galleries (Marlborough) entered into an agreement which provided in part as follows:

> The following shall constitute our agreement with respect to the sale by us of sculpture, drawings and graphics created by you (hereinafter referred to as "your work"):
>
> 1. During the period of 5 years commencing on the date hereof, we shall have the exclusive right, in any part of the world, to offer for sale and to authorize others to offer for sale all items of your work owned by you. You shall initially deliver each such item of your work to us at such location as we shall indicate.
>
> 2. During such period of 5 years, we shall also have the exclusive right to arrange and to authorize others to arrange the publication and or sale, in any part of the world, of books and catalogues containing illustrated reproductions of your work.
>
> 3. During such period of 5 years, we shall arrange for exhibitions of your work in New York, London, Rome and such other places as you and we shall jointly determine. We shall be responsible for all of the expenses of such exhibitions (including advertising and catalogue costs) other than insurance and shall bear the entire cost of storing all items of your work delivered to us pursuant to this agreement.

4. You have furnished us with photographs of each item of your work owned by you on the date hereof. The price at which we shall offer each such item for sale shall not be less than the price set forth on the back of such photograph. We shall agree with you as to the minimum sale prices of those items of your work created in the future. Minimum prices may be changed from time to time in such manner as you and we shall jointly agree.

* * *

6. Upon the sale by us of any item of your work, we shall reimburse ourselves from the actual net proceeds for any initial shipping cost and insurance cost advanced to you with respect to such item. In addition, as compensation for our services, we shall retain ⅓rd of the balance of such net proceeds. The remaining ⅔rds of such balance, less any amounts due to us hereunder, shall be paid to you in United States dollars on a quarterly basis.

* * *

8. This agreement shall be construed in accordance with the laws of the State of New York and shall be binding upon and inure to the benefit of your and our respective executors, administrators, successors and assigns.

This contract was renewed by Smith's estate on June 3, 1968.

Smith's sculptures were mostly sold at retail to museums and individual collectors during his lifetime.

Appendix A—Findings of Fact and Opinion of Tax Court

Between June 2, 1963, and Smith's death on May 23, 1965, Marlborough's efforts (which included an exhibition of 29 selected works at Marlborough's Gallery in New York in October of 1964) resulted in the following sales:

Date	Pieces sold	Total sales price	Commissions	Artist
Nov. 20, 1963	1	$ 6,000	$ 2,000	$ 4,000
June 29, 1964	1	14,000	4,666	9,334
Nov. 12, 1964	1	40,000	13,333	26,667
Nov. 14, 1964	1	8,500	2,833	5,667
Jan. 7, 1965	1	40,000	13,333	26,667

During the 2 years following Smith's death, Marlborough effected the following sales, presented below in summary fashion:

Period	Number of works sold	Total sales price	Commissions	Artist
5/23/65-5/23/66	16	$269,383.00	$ 89,795	$179,588.00
5/24/66-5/31/67	52	718,951.67	240,264	478,687.67

During his lifetime and at the time of his death, several factors militated against Smith's becoming a commercially successful artist. First, abstract sculptures attract far fewer buyers than do paintings, partly because the latter more easily fit into the decor of a buyer's household or of a museum. While Smith received mixed critical acclaim from his contemporaries and art critics, his work was not particularly appealing to the general public upon whom an artist must rely for the great bulk of his sales. Secondly, the size of his works (particularly those of the "Cubi" series, his most highly regarded series of sculptures), re-

quired a prospective buyer to have a great deal of space available for installation in order to properly exhibit them. Indeed, 185 of the 425 works in Smith's possession at his death were over 7 feet tall and comprised 80 percent of the total retail selling prices estimated by Smith's executors. Finally, Smith's works were priced relatively high, and it was generally acknowledged in the art world that the lowering of an artist's prices signified a lack of confidence in the quality of the work.

Towards the end of Smith's life, Smith began to receive critical recognition of his work and honors commensurate with his status as one of the leading American abstract sculptors. He was appointed to the National Council of Art in 1964, the first such artist to receive this honor; he also participated in the 1962 Festival of Two Worlds in Spoleto, Italy, a guest of the Italian Government and American composer, Gian Carlo Menotti, as well as being awarded a major prize at the 1959 Sao Paulo Biennial of Modern Art. Upon his death, several national magazines which had hitherto ignored Smith noted his contribution to American art, catapulting him into national prominence.

Smith was a prolific sculptor and constantly created a larger number of sculptures than the market could readily absorb. He customarily produced series of between 10 and 30 sculptures which were similar in appearance, technique, and scale. The most prized of Smith's works were those of the "Cubi" series, which consisted of 28 or 29 works of welded, polished steel cubes ranging from 7 feet to 9 feet in height and being offered for sale for between $35,000 and $50,000. Smith's sculptures generally tended to be

large and consequently expensive to transport and to warehouse.

At the time of Smith's death and for an undetermined period thereafter, the general public was not aware of how many of Smith's works were in his possession at the time of his death. Had the public been aware of this fact, and had all 425 pieces been made immediately available for sale, the estate and Marlborough could reasonably have expected to get substantially less money for them than if the works were slowly disseminated in the market over a period of years. It was also important to "hold back" certain works for sale at a future date (particularly the more desirable of Smith's works) in order to sustain interest in his works over the 10-year period of time envisioned by the estate as necessary to liquidate Smith's works.

In valuing the works of art included in the return, the executors first computed the price each piece would bring if sold individually at retail at the time of death, the total hypothetical price being $4,284,000. Then they discounted this figure by 75 percent on the theory that these works could only be sold at the time of death to a bulk purchaser for resale, and then reduced this figure by one-third to cover Marlborough's commission. The resulting figure of $714,000 was reported as the date-of-death value of the sculptures.

The terms of decedent's last will anent the administration both of the estate and of the testamentary trust for the benefit of decedent's two minor daughters provide, in part, as follows:

> THIRD: My Executors and Trustees shall take possession of my estate and are hereby given power

to hold, manage, operate, control, sell, convey, lease, mortgage, encumber, renew encumbrances, and assign the said estate, or any part thereof, to collect all the rents, income and profits therefrom; to pay all taxes, insurance charges, necessary repairs and other proper expenses connected therewith; and with full power to sell and convey, from time to time, and to mortgage and encumber such parts of my property and estate, real or personal, including all of my works of art, as in their best judgment and discretion may be expedient. The proceeds derived from any such sale or sales shall be invested and reinvested from time to time in such securities and property, real or personal, as my Trustees may elect.

In the disposal of my works of art and other property, real and personal, said Trustees shall have as full and unlimited power and discretion as if said trust property were their own absolute estate.

The coexecutors have not yet filed a final accounting of the estate with the New York Surrogate's Court having jurisdiction of the administration of the estate. Their most recent intermediate accounting embraced a period ending on April 30, 1970. In the accountings, an aggregate of $1,187,144.67 representing commissions paid to Marlborough was allowed by the Surrogate's Court.

From May 23, 1965, through April 30, 1970, the estate was required to pay $789,970.38 for various administration expenses, debts of the decedent, and taxes, of which amount $390,481.20 is allowable as a deduction under section 2053. At the time of decedent's death, total cash available to the

estate from sources other than the sale of sculptures amounted to $210,647.08. $868,984.95 worth of sculptures were sold through Marlborough to cover the difference between the expenses enumerated above and ready cash, or $579,323.30. Commission expenses of $289,661.65 were incurred in respect of such sales.

In addition to the aforementioned expenses, the executors paid $55,937.75 to the decedent's widow for the support of the two minor children. The executors have also made payments totaling $1,392,491.69 to the trusts created under decedent's will for the benefit of the aforementioned children. While petitioner has claimed a deduction for all commission expenses incurred, respondent has disallowed any deduction for commission expenses in excess of $289,661.65.

ULTIMATE FINDING OF FACT

The fair market value of the 425 sculptures at the time of Smith's death was $2,700,000.

OPINION

David Smith, a sculptor, died possessed of 425 pieces of non-representational metal sculptures created by his own efforts. The scupltures were valued at $714,000 in the estate tax return. Respondent, in his deficiency notice, determined that they should be valued at $5,256,918 but now concedes that they should be valued at not more than $4,284,000. It is this issue of valuation, together with a related question involving the deductibility of certain expenses, which the parties have placed before us for decision.

We approach the task with considerable circumspection, recognizing that this case involves a highly unusual set of circumstances to which the usual, simplistic valuation approach may not be fully applicable and that, in the final analysis, our ultimate determination of value will necessarily constitute a "Solomon-like pronouncement." See *Morris M. Messing*, 48 T.C. 502, 512 (1967).

Initially, we are faced with certain broad assertions by petitioner, which attack this proceeding in its entirety. First, it argues that the number and nature of the sculptures, coupled with the limited scope and vagaries of the market in which they might be disposed of, make valuation as of the date of death impossible. Consequently, it argues that we should determine a zero value and that any other determination of value would be a violation of its constitutional rights.[1] We find this argument to be without merit. Valuation has been consistently recognized as an inherently imprecise process. See *Morris M. Messing, supra.* Difficulties encountered in determining value, e.g., the presence of a limited market or other restrictive elements, have never been considered a bar to accomplishment of that task, much less to have acquired a constitutional significance, although such elements are factors to be taken into account.[2] *Publicker* v. *Commissioner*, 206 F. 2d 250 (C.A. 3, 1953); see also *George P. Fisher, Executor*, 3 B.T.A. 679 (1926).

1. Petitioner claims the benefit of the "equal protection" doctrine, the freedom-of-expression principle embodied in the first amendment, and the due-process clause of the fifth amendment.

2. In an estate tax case, unlike an income tax case, there is an overriding necessity to determine a value. See *Burnet* v. *Logan*, 283 U.S. 404 (1931); Simpson, J., dissenting, in *Stephen H. Dorsey*, 49 T.C. 606, 634-635 (1968).

Moreover, the record herein shows clearly that the sculptures had value at the date of Smith's death, so petitioner's assertion that they had a zero value is factually baseless.

Petitioner next contends that the process by which respondent arrived at the valuation determined in his deficiency notice was "without foundation, unreasonable and arbitrary." This argument we also reject as without merit. Even if we were to decide that respondent's determination was erroneous, neither that consequence, nor the fact that respondent has reduced his claimed valuation from that set forth in the deficiency notice, constitutes sufficient grounds for disregarding the deficiency notice or relieving petitioner of its burden of proof. *Jacob D. Farber*, 43 T.C. 407, 428-429 (1965). Nothing in this record permits the conclusion that respondent's action was so utterly unjustified as to fall within the ambit of *Helvering* v. *Taylor*, 293 U.S. 507 (1935). Moreover, it is well established that—at least where unconstitutional conduct is not involved—the courts will not inquire into the administrative policies and procedures employed by respondent prior to making his determination. *Arthur Figueiredo*, 54 T.C. 1508 (1970).

Finally, petitioner contends that payment of a prior proposed deficiency was tantamount to a closing agreement and should preclude respondent from asserting any further deficiency. This argument must also be rejected. There is no evidence that the requirements that a closing agreement be in writing and signed by the Secretary of the Treasury or his delegate have been met. Sec. 7121; sec. 301.7121-1, Proced. & Admin. Regs. Mere payment of an asserted deficiency does not satisfy those requirements.

Payson v. *Commissioner*, 166 F. 2d 1008 (C.A. 2, 1948); cf. *Helen Rich Findlay*, 39 T.C. 580, 588-589 (1962), affirmed in part and reversed in part on other issues 332 F. 2d 620 (C.A. 2, 1964).

We now turn our attention to the critical issue in this case—the determination of the fair market value of the sculptures at the time of Smith's death. In the final analysis, this is essentially a question of fact. *Daniel S. McGuire*, 44 T.C. 801, 812 (1965). As we view the record herein, petitioner does not complain about the mathematical result of respondent's calculation of value, if it is determined that respondent accorded appropriate weight to the various elements involved. Indeed, the value attached by respondent to each piece of sculpture, if it had been sold separately, is identical with the value established by petitioner on the same basis. Where they part company is with respect to the weight to be accorded to the fact that each item would be sold on a market on which 424 other items would simultaneously be available. Respondent claims that such simultaneous availability would have no adverse impact and that the fair market value of each item should simply be determined by the price at which the item could be separately sold in the retail art market on a "one-at-a-time" basis in accordance with the provisions of section 20.2031-1(b), Estate Tax Regs.[3] Petitioner asserts that

3. Sec. 20.2031-1(b). *Valuation of property in general.* The value of every item of property includible in a decedent's gross estate under sections 2031 and 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither

this is totally unrealistic in this case; that the problem must be viewed in the context of what could be obtained if all 425 sculptures were offered for sale at the moment of death; that any purchaser under these circumstances could only be a person or syndicate acquiring the bulk of the sculptures for resale; that such person would be required to make a large cash investment which could be recouped with an acceptable profit only over a long period of time; and that such person would pay only 25 percent of the

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being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. * * * The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. *All relevant facts and elements of value as of the applicable valuation date shall be considered in every case.* The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. * * * [Emphasis added.]

This regulation was amended to read as above on June 7, 1965, a date subsequent to Smith's death. See T.D. 6826, 1965-2 C.B. 367. Both parties have dealt with this case on the basis of the amended language nevertheless being applicable, and we have no reason to question this approach. See sec. 7805(b). Moreover, our ultimate decision as to the proper valuation would be the same, whichever regulation were applied.

separate "one-at-a-time" value which, after a further discounting by one-third to take into account the effect of the contract with Marlborough, results in a valuation of $714,000.

We find it unnecessary, in this unusual case, to make any hard-and-fast choice between the two approaches urged by the parties.[4] On the one hand, we think that the initial 75-percent discount, which petitioner has applied to the "one-at-a-time" value in order to determine the price which a purchaser would pay for all the sculptures, is too high. On the other hand, we think that respondent should have given considerable weight to the fact that each item of sculpture would not be offered in isolation. We think that, at the very least, each willing buyer in the retail art market would take into account, in determining the price he would be willing to pay for any given item, the fact that 424 other items were being offered for sale at the same time. The impact of such simutaneous availability of an extremely large number of items of the same general category is a significant circumstance which should be taken into account.[5] In this connection, the so-called blockage rule utilized in connection with the sale of a large number of secu-

4. For a discussion of some of the difficulties involved in applying respondent's regulations on a broad-brush basis, see "Federal Estate and Gift Taxation: Amended Regulations Change Valuation for Estate and Gift Taxes," 1966 Duke L. J. 248 *et seq.*; Report of the Committee on Estate and Gift Taxes, 19 Bull. A.B.A. Taxation Section, No. 4, p. 71 (July 1966).

5. See sec. 20.2031-1(b), Estate Tax Regs. fn. 3 *supra*: "All relevant facts and elements of value as of the applicable valuation date shall be considered *in every case.*" (Emphasis added.) Compare *Bankers Trust Co.* v. *United States*, 284 F. 2d 537 (C.A. 2, 1960); *Old Kent Bank & Trust Co.* v. *United States*, 292 F. Supp. 48 (W.D. Mich. 1968).

rities furnishes a useful analogy. See *Maytag* v. *Commissioner,* 187 F. 2d 962, 965 (C.A. 10, 1951), affirming a Memorandum Opinion of this Court; *Helvering* v. *Maytag,* 125 F. 2d 55, 63 (C.A. 8, 1942), affirming a Memorandum Opinion of this Court; *Helvering* v. *Safe Deposit & Trust Co. of Baltimore,* 95 F. 2d 806, 811-812 (C.A. 4, 1938), affirming 35 B.T.A. 259 (1937); *Estate of Robert Hosken Damon,* 49 T.C. 108, 117 (1967). We think that a museum or individual collector of art objects would not completely ignore the resale value of a given item, although it obviously has far less significance than in the case of a dealer. Moreover, the "retail market" claimed by respondent may well encompass the use of an auction method of disposal (to be distinguished from the usual forced-sale concept) for at least a part of the art objects;[6] in such a situation the presence of a large number of pieces on the market at one time would be a most material factor. Under the foregoing circumstances, we think that, in this case, the amount which an *en bloc* purchaser for resale would pay and the aggregate of the separate "one-at-a-time" values to be obtained by a variety of dispositions in the "retail market" would be the same.

We have taken into account certain other elements involved in the valuation process as they existed at the moment of death. These include[7] the fact that Smith's reputa-

6. We note that art objects are frequently disposed of by way of auction (to be distinguished from a forced-sale auction) and that estimates of prices to be obtained by a sale of such objects in this fashion are of some significance. See *Eugene P. Mathias,* 50 T.C. 994, 999 (1968).

7. In listing such elements, we do not mean to imply that we have set forth every consideration which has influenced our decision herein.

tion as a sculptor had not fully blossomed; the relatively low level of acceptability of nonrepresentational sculpture in the market place; the distribution of the 425 items according to size, period in Smith's life during which they were created, and their expression, in relative terms, of the quality of Smith's work; Smith's tendency to work in series and whether or not a given item was part of a complete series owned by Smith at his death; the number of sales by Smith (or his agents) in the 25 years before his death and the prices at which sales were made during the period immediately preceding and following death;[8] the fact that the bulk of the items was located at Bolton Landing, N.Y., which was relatively inaccessible, and that a large number of the items could not have been readily transported to a location more accessible to potential buyers.[9]

One element of value which petitioner urges be taken into account relates to its obligation to Marlborough by virtue of the exclusive agency contract which Smith made and which survived his death. Petitioner insists that any value based upon the gross sales price must be reduced by one-third to take into account the commissions to which Marlborough was entitled. We think any reduction in value with respect to this element is precluded by the de-

8. Provided they are not too far removed from the critical date, sales before and after such date may be used to corroborate the ultimate determination of value. In this case, we have given little weight to sales taking place more than 2 years after Smith's death. See *Fitts' Estate* v. *Commissioner*, 237 F. 2d 729, 731 (C.A. 8, 1956), affirming a Memorandum Opinion of this Court; *James Couzens*, 11 B.T.A. 1040, 1165 (1928); cf. sec. 20.2031-2(b), Estate Tax Regs.

9. Compare sec. 20.2031-1(b), Estate Tax Regs., fn. 3 *supra*, which recognized the propriety of "taking into account the location of the item."

cided cases. In *Publicker* v. *Commissioner, supra,* the court refused to permit the price which could be realized on the sale of a piece of jewelry to be reduced by the Federal excise tax which would have been payable. Cf. also *Estate of Frank Miller Gould,* 14 T.C. 414 (1950).[10] The measure of value laid down by these cases is what could be *received* on, not what is *retained* from, a hypothetical sale. Even if one may question the equating of "price" with the gross price including tax, in situations involving the excise tax, it cannot be gainsaid that the "price" herein is what a purchaser would pay for a piece of sculpture. Cases such as *Estate of Albert L. Salt,* 17 T.C. 92 (1951), relied upon by petitioner, are not in point. Concededly, they limit the value of property subject to a restrictive agreement, but they, too, look to what the estate of the decedent can obtain, not to the net it will retain when the property is sold. Nor does an examination of the contractual relationship between Smith and Marlborough reveal sufficient elements to construct a joint venture which might have given Marlborough an interest in the sculptures themselves with a consequent effect on the value at death (cf. Raum, *J.,* concurring, in *Harry C. Porter, Transferee,* 49 T.C. 207, 227 (1967))—an effect which we might add could have favorable as well as unfavorable aspects to a taxpayer in the valuation process.

Having carefully considered the entire record herein, we conclude that the fair market value of the 425 sculptures at the moment of Smith's death was $2,700,000.

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10. While both *Publicker* and *Gould* are gift tax cases, the provisions relating to value in the gift and estate tax areas have been held to be *in pari materia. Merrill* v. *Fahs,* 324 U.S. 308, 311-313 (1945).

We now address ourselves to the remaining issue in the case, namely, the extent to which the commissions to which Marlborough was entitled are deductible as administration expenses under section 2053(a).[11]

The argument of the parties essentially focuses on section 20.2053-3(d), Estate Tax Regs., which provides in pertinent part as follows:

> (d) *Miscellaneous administration expenses.*
>
> • • •
>
> (2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale, • • •

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11. SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES

(a) GENERAL RULE—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

This regulation has been in effect in substantially the above form since 1919 and its restrictive language was sustained in *Estate of Christine Swayne,* 43 T.C. 190, 201-202 (1964). Compare *Ballance* v. *United States,* 347 F. 2d 419, 423 (C.A. 7, 1965).

The respondent concedes that, to the extent that the sculptures had to be sold to pay taxes, debts, etc., commissions attributable to such sales are deductible. Petitioner argues that additional Marlborough commissions[12] are deductible on the ground that they were incurred to preserve the estate and/or they were incurred in order to effect distribution of the estate. We think petitioner's claim must be rejected. *Estate of Christine Swayne, supra.*

The mere fact that the commissions claimed by petitioner herein to be deductible were allowed by the New York Surrogate's Court is not sufficient. The clause "as are allowable by the laws of the jurisdiction * * * under which the estate is being administered," contained in section 2053(a), establishes a threshold and not an exclusive condition; the requirements of respondent's regulations must also be satisfied. *Pitner* v. *United States,* 388 F. 2d 651, 659-660 (C.A. 5, 1967); *Estate of Christine Swayne, supra.* Compare *Estate of James S. Todd, Jr.,* 57 T.C. 288 (1971), where we held that the claimed expense had both been al-

12. It is not clear to us the precise extent to which petitioner claims deductibility—i.e., whether it would limit its claim to those commissions actually revealed by this record as having been paid or whether it would anticipate that a favorable decision on our part would entitle it to keep the question of tax liability open until the estate had made its last sale and paid the applicable commissions to Marlborough, an event which has apparently not yet taken place. In view of our disposition of the issue at hand, we find it unnecessary to seek clarity on this point.

lowed by the Probate Court and was necessarily incurred to preserve the estate. Compare also *Dauphin Deposit Trust Co.* v. *McGinnes,* 208 F. Supp. 228, 237-238 (M.D. Pa. 1962), affirmed on another issue 324 F. 2d 458 (C.A. 3, 1963), and *In Re Bartlett's Estate,* 153 F. Supp. 674, 678 (E.D. Pa. 1957), both of which rested on a presumption of "necessity" under Pennsylvania law.

Clearly, there was no necessity under the will to sell the sculptures beyond the point necessary to discharge funeral and administration expenses and claims. Indeed, the will itself contemplated a distribution of the sculptures in kind to the trusts for the benefit of Smith's daughters. Smith was under no obligation to support his daughters after his death nor were his executors under any such obligation. *In Re Garcy's Trust,* 19 App. Div. 2d 811, 243 N.Y.S. 2d 464 (1st Dept. 1963). The trust was the vehicle for support and, if cash were necessary for that purpose, the trustees, not the executors, were the ones required to make the decision to sell and it is they who would have incurred the concomitant obligation to pay Marlborough its commission. To the extent that the executors made decisions to sell in order to provide support money, they were acting on behalf of the trust and not on behalf of the estate. Cf. *Sharpe's Estate* v. *Commissioner,* 148 F. 2d 179, 181 (C.A. 3, 1945).

We are not impressed with petitioner's argument that, because of the volatile nature of the art market, it was necessary in order to "preserve the estate" to accept any reasonable offer which may have been made. Such a general thesis applies in almost every estate situation and the area of discretion vested in the executors is very broad

indeed. In fact, the schedule of actual sales and the increasing prices the executors were able to obtain indicate that haste might well have made waste. Certainly, there is nothing in the record to justify analogizing the sculptures to perishable goods, which by their very nature have to be sold promptly, or with an unexpectedly serious development which sometimes may make sales the sine qua non of preserving the estate.

The regulations appear to be directed toward safeguarding the integrity of the estate tax by making certain that administration expenses which are properly deductible will normally be limited to those which could be anticipated as being necessarily incurred and paid during the period of administration. To allow the commissions to the extent claimed by the petitioner herein would seriously undermine the achievement of that sound objective.[13] Moreover, there can be no assurance that all or any specific number of art objects would in fact be sold with the result that the amount of commissions payable would, in any event, be highly speculative. Cf. *Estate of John B. Sharpe,* 3 T.C. 612, 626 (1944), affirmed sub nom. *Sharpe's Estate* v. *Commissioner,* 148 F. 2d 179 (C.A. 3, 1945).[14]

13. A similar result would obtain if deduction of commissions were allowed on the basis that they were claims against the estate, contingent and speculative at death but becoming a reality during the period of administration. Moreover, any such rationale might require an evaluation of the contract as an asset insofar as it enabled the estate to obtain Marlborough's services. Cf. *Commissioner* v. *Wragg,* 141 F. 2d 638 (C.A. 1, 1944); *Parrott* v. *Commissioner,* 30 F. 2d 792 (C.A. 9, 1929); compare *Estate of George Herbert Atkins,* 2 T.C. 332, 346-347 (1943).

14. We also note that the obligation to use Marlborough as a selling agent had only approximately 3 years to run at the time of Smith's death.

We hold that petitioner's deduction under section 2053 is limited to amounts paid for administration expenses, debts, and taxes in the sum of $390,481.20 plus $289,661.65 representing commissions paid to Marlborough, without prejudice to petitioner's rights under Rule 51.[15]

Reviewed by the Court.

Decision will be entered under Rule 50.

TIETJENS, *J.*, dissenting and concurring: This case was tried before Judge John W. Kern. Judge Kern died before he decided the case which then was assigned to me without objection.

I do not disagree on the valuation issue so far as the discussion of the legal principles to be applied is concerned. I would, however, give more weight to the actual sales prices of various pieces of statuary sold both before and after the sculptor's death as well as uncontested evidence of values placed on the separate pieces by both the respondent and petitioner if they had been sold separately. Accordingly I would find the fair market value of the 425 sculptures to be $4,284,000.

On the remaining issue I concur.

GOFFE, *J.*, concurring in part, dissenting in part: I concur with the majority of the Court as to the fair market

15. Since the amount of $289,661.65 does not include an allowance for commissions on sales necessary to raise the funds with which to pay any estate taxes beyond those already paid, i.e., the additional estate tax resulting from our decision herein, a further deduction for such commissions and any other items encompassed within Rule 51 should be taken care of in the Rule 50 computation.

value of the sculptures at the date of decedent's death but I must respectfully dissent on the issue of the extent of deductibility of selling commissions as administration expenses.

Petitioner did not raise as an issue the possible invalidity of section 20.2053-3(d)(2), Estate Tax Regs. The opinion of the majority, however, determines that such section of the regulations is valid because of its age, its approval in *Estate of Christine Swayne, supra,* and because it is necessary in order to safeguard "the integrity of the estate tax by making certain that administration expenses which are properly deductible will normally be limited to those which could be anticipated as being necessarily incurred and paid during the period of administration."

I am constrained to dissent because I think it obvious that the section of the regulations is clearly outside the scope of the Code and contrary to the intent of Congress; the age of the section gives it no validity because it is contrary to the committee reports covering reenactment of the Code section; and because this Court did not pass upon the validity of the section in *Swayne,* but has, instead, ignored the application of the section in other cases, as have other courts.

Section 2053(a)(2) of the Internal Revenue Code of 1954 provides as follows:

> SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES.
>
> (a) GENERAL RULE.—For purposes of the tax imposed by section 2001, the value of the taxable estate

shall be determined by deducting from the value of the gross estate such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

Section 20.2053-3(d)(2), Estate Tax Regs., provides as follows:

(d) *Miscellaneous administrative expenses.*

* * *

(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale, * * *

It is apparent that the regulations impose a limitation upon the deductibility of selling expenses not prescribed

by the Code, to wit, the sale giving rise to the expense must be necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate or to effect distribution. It is this limitation which the majority of the Court applies against the petitioner to reduce its deduction for selling expenses.

I am not unmindful of the principle of statutory reenactment upon which the majority apparently relies for its observation that the section 20.2053-3(d)(2) of the regulations has been in effect since 1919. The principle of statutory reenactment is a rule of statutory construction and must be indulged in to find that Congress, by enacting section 2053(a)(2) of the Internal Revenue Code of 1954, intended to incorporate therein section 81.35 of Regs. 105 (not materially different from section 20.2053-3(d)(2), Estate Tax Regs.). The committee reports for the Internal Revenue Code of 1954 reflect no consideration of section 81.35 of Regs. 105. House Report No. 1337 is as follows:

> G. *Expenses, indebtedness, and taxes* (sec. 2053)
>
> Funeral expenses, administration expenses, claims against the estate and unpaid mortgages are deductible in computing the taxable estate under present law. However, this deduction is limited to those expenses allowable by the laws of the jurisdiction under which the estate is being administered and cannot exceed the value of the property included in the gross estate subject to claims, that is, the probate estate. Thus, if the decedent has placed most of his assets in a trust (not includible in his probate estate) funeral and other expenses actually

> paid * * * out of the trust assets are not allowed as a deduction to the extent they exceed the value of the property in the probate estate.
>
> These arbitrary distinctions have been removed under your committee's bill. Expenses incurred in connection with property subjected to the estate tax, although not in the probate estate, are to be allowed as deductions, if the expenses are of the type which would be allowed as deductions if the property were in the probate estate and they are actually paid within 1 year of the decedent's death.
>
> In addition, expenses in connection with property subject to claims are to be allowed without regard to the total value of the probate estate if they are paid within the period provided for the assessment of the estate tax. [H. Rept. No. 1337, to accompany H.R. 8300 (Pub. L. No. 591), 83d Cong., 2d Sess., p. 91 (1954). S. Rept. No. 1622, to accompany H.R. 8300 (Pub. L. No. 591), 83d Cong., 2d Sess., pp. 124-125 (1954).]

The lack of indication that Congress considered the regulations brings the matter into precisely the holding of the Supreme Court in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), where the Court stated at page 431 of its opinion:

> Re-enactment—particularly without the slightest affirmative indication that Congress ever had the *Highland Farms* decision before it—is an unreliable indicium at best.

I submit that Congress considered only the limitation of State law in enacting section 2053(a)(2) of the Internal Revenue Code of 1954 as the report quoted above obviously demonstrates.

The majority feels that the limitation imposed only by the regulations is necessary to safeguard the integrity of the estate tax. Congress apparently did not feel such a safeguard was necessary. Congress provided that deductions for selling expenses were allowable if permitted under State law. That is the sole limitation provided by Congress in the statute and reflected in the committee reports. If additional safeguards are needed they should come from Congress, not from the Secretary or his delegate in the form of unauthorized regulations. In my opinion the integrity of the estate tax must be safeguarded from unauthorized and unwarranted limitations imposed by regulations as well as abuses which may occur elsewhere.

The majority indicates that section 20.2053-3(d)(2), Estate Tax Regs., has been sustained by this Court in *Estate of Christine Swayne, supra.* Nothing in that opinion indicates that the validity of the regulations was challenged. The Court did not state that the regulations were valid. In the instant case the validity of the regulations was not challenged but the majority of the Court undertakes to decide they are valid. The opinion in *Swayne* distinguishes *Estate of Louis Sternberger,* 18 T.C. 836, (1952), affd. 207 F. 2d 600 (C.A. 2, 1953), reversed on other grounds 348 U.S. 187 (1955).[1] It is distinguished on the

1. The issue of deductibility of selling expenses in *Sternberger* was not raised on appeal.

ground that the Sternberger estate was being administered under the laws of New York rather than under the laws of Connecticut where the Swayne estate was being administered. The Court specifically found in *Sternberger* that the proceeds from the property sold which gave rise to the expenses deducted were not needed to pay debts or expenses but were allowable under New York law. I believe the *Sternberger* case is squarely in point and the majority opinion herein is incorrect where it says at pages 660-661 that:

> The mere fact that the commissions claimed by petitioner herein to be deductible were allowed by the New York Surrogate's Court is not sufficient. The clause "as are allowable by the laws of the jurisdiction * * * under which the estate is being administered," contained in section 2053(a), establishes a threshold and not an exclusive condition; the requirements of respondent's regulations must also be satisfied. * * *

My position is supported by the opinion of the U.S. Court of Appeals for the Seventh Circuit in *Ballance* v. *United States*, 347 F. 2d 419 (C.A. 7, 1965). It may well be that in fulfilling the test of allowability under State law the taxpayer is also fulfilling a requirement of that section of the regulations which I find invalid. Be that as it may, the test is still State law. See *Dauphin Deposit Trust Co.* v. *McGinnes*, 208 F. Supp. 228 (M.D. Pa. 1962), affirmed on another issue 324 F. 2d 458 (C.A. 3, 1963), and *In Re Bartlett's Estate*, 153 F. Supp. 674 (E.D. Pa. 1957).

I believe this situation existed in our opinion in *Estate of James S. Todd, Jr., supra,* cited by the majority; i.e., allowability under State law fulfilled the test set forth in the regulations. I see nothing in the *Todd* opinion, however, indicating that the validity of the regulations was in issue or necessarily determined to be valid.

For the foregoing reasons, I believe petitioner should be allowed to deduct all the selling expenses paid.

FORRESTER, DAWSON, and HOYT, *JJ.*, agree with this concurring and dissenting opinion.

WHITEY, *J.*, agrees only with respect to the dissent.

APPENDIX B

Majority and Dissenting Opinions of the United States Court of Appeals for the Second Circuit

ESTATE OF DAVID SMITH, Deceased, *et al.*,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

No. 133, Docket 74-1617.

United States Court of Appeals,
Second Circuit.

Argued Nov. 4, 1974.

Decided Feb. 4, 1975.

George G. Wolf, Tax Div., Dept. of Justice, Washington, D. C. (Scott P. Crampton, Asst. Atty. Gen., Gilbert E. Andrews, and William S. Estabrook, Attys. Tax Div., Dept. of Justice, Washington, D. C., on the brief), for respondent-appellee.

M. Bernard Aidinoff, New York City (Sullivan & Cromwell, Ira M. Lowe, Henry Christensen, III, and Laurie L. Malman, New York City, on the brief), for petitioners-appellants.

Appendix B—Majority and Dissenting Opinions

Before KAUFMAN, Chief Judge, and ANDERSON and MULLIGAN, Circuit Judges.

ROBERT P. ANDERSON, Circuit Judge:

David Smith, a sculptor, died on May 23, 1965 possessed of 425 pieces of sculpture, which he had created, along with cash and other liquid assets totalling $210,647.08. His will, dated January 21, 1965, was admitted to probate by the Surrogate's Court of Warren County, New York, and Ira M. Lowe, Clement Greenberg, and Robert Motherwell were duly appointed and qualified as co-executors.

Had the large number of artistic works which he left at his death been generally known and had all of these works been immediately placed on the market they would have brought substantially less than could be received by feeding them slowly into the market over a period of time. Shortly after Smith's death, therefore, the executors began an orderly process of gradual liquidation of the Estate's holdings of sculpture through Marlborough-Gerson Galleries, which was entitled to a commission on each piece of sculpture sold in accordance with a 1963 contract that was subsequently renewed by the executors in 1968 and 1970. From May 23, 1965 through April 30, 1970, an aggregate of $1,187,144.67 in commissions was paid to Marlborough and allowed by the Surrogate's Court. Further commissions of $396,400 were paid by the Estate to Marlborough from May 1, 1970 through August 21, 1973 and the Surrogate's Court allowed these as well.

A federal estate tax return was filed on August 24, 1966 and a deficiency was agreed upon and paid on July 10,

1968. On August 7, 1969, the Commissioner of Internal Revenue (Commissioner) issued a notice of deficiency for $2,444,629.17 based upon a valuation of Smith's estate of $5,256,918 and a disallowance of any payments of commissions in excess of $289,661.65.

Upon a petition by the executors for redetermination, the Tax Court reduced the value of the estate to $2,700,000, and no appeal has been taken from this appraisal. From the time of Smith's death to August 21, 1973, the executors paid to the Galleries, with the approval of the Surrogate's Court[1], the total sum of $1,583,544.67 in commissions for sales of Smith's works, but the Tax Court allowed the Estate only $750,447.74 as deductions for sales commis-

1. Section 222 of the New York Surrogate's Court Act, in effect at the time of decedent's death, provided as follows:

> "§222. Payment of expenses incurred by representative.
>
> An executor, administrator, guardian or testamentary trustee may pay from the funds or estate in his hands, from time to time, as shall be necessary, his legal and proper expenses of administration necessarily incurred by him, including the reasonable expense of obtaining and continuing his bond and the reasonable counsel fees necessarily incurred in the administration of the estate. Such expenses and disbursements shall be set forth in his account when filed, and settled by the surrogate."

§222 was succeeded as of September 1, 1967, more than two years after decedent's death, by §11-1.1(b)(23) of the New York Estates, Powers and Trusts Law (McKinney's Consol. Laws, c. 17-b, 1967) (renumbered as of June 22, 1973 as 11-1.1(b)(22)), which provides that a fiduciary is authorized:

> "(23) In addition to those expenses specifically provided for in this paragraph, to pay all other reasonable and proper expenses of administration from the property of the estate or trust, including the reasonable expense of obtaining and continuing his bond and any reasonable counsel fees he may necessarily incur."

The revisers' notes state that subparagraph (b)(23) is intended to incorporate the substance of §222 of the Surrogate's Court Act.

sions under §2053(a)[2] of the Internal Revenue Code of 1954 (26 U.S.C. §2053(a)) and Treas. Reg. §20.2053-3.[3] This allowance was the exact amount necessary to pay the

2. Section 2053 of the Internal Revenue Code of 1954 (26 U.S.C. §2053(a)), provides as follows:

"(a) *General rule*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered."

3. Treas.Reg. §20.2053-3 (1958), as amended by T.D. 6826, 30 F.R. 7708, June 15, 1965, provides in relevant part:

"§20.2053-3 Deduction for expenses of administering estate.

(a) *In general.* The amounts deductible from a decedent's gross estate as 'administration expenses' of the first category (see paragraph (a) and (c) of §20.2053-1) are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions . . ..

* * *

(d) *Miscellaneous administration expenses . . .*

(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration or taxes, to preserve the estate, or to effect distribution . . .."

decedent's debts, the expenses of administration, and taxes as finally adjudicated.

Appellants first argue that, given the speculative and volatile market value of the sculptures, which were the Estate's major assets, they were under a duty to liquidate sufficient of these assets as were necessary adequately to preserve their value, provide for debts, anticipated administration expenses and taxes of the Estate and diversify properly the Estate's investments. In particular, they claim to have been put on notice by the Commissioner's Notice of Deficiency dated August 7, 1969 that they had to be prepared to meet a contingent liability of $2,444,629.17 in additional federal estate taxes and $570,193.23 in additional New York estate taxes, and that sales to meet these obligations alone would have incurred more in commissions than the entire $1,602,644.67 which they in fact paid and now seek as a deduction. The disputed sale expenses, they contend, were therefore incurred as necessary steps in the course of their administration of the Estate and are deductible under Treas. Reg. §20.2053-3(d)(2). The evidence indicates, however, that all of the expenses disputed by the Commissioner were incurred *before* the notice of deficiency was issued, all commissions incurred subsequent to the notice of deficiency having been allowed. In fact, the $579,323.30 in cash needed to pay the expenses, debts, and taxes incurred by the Estate to April 30, 1970 had been realized by the Estate from the sale of sculpture by February 28, 1967. Under these circumstances the Tax Court's determination that no more than $750,447.74 in sales commissions were necessary either to preserve the estate or

pay debts, administrative expenses and taxes is not clearly erroneous. *See* Commissioner v. Duberstein, 363 U.S. 278, 80 S.Ct. 1190, 4 L.Ed.2d 1218 (1960).

Appellants further contend that the allowance by the New York Surrogate's Court of all of the sales commissions as administrative expenses is determinative of their deductibility under §2053(a) of the Internal Revenue Code of 1954 and Treas.Reg. §20.2053-3(d)(2), and that if Treas. Reg. §2053-3(d)(2) is read to deny a deduction for administrative expenses properly allowed by state law, §20.2053-3(d)(2) is invalid. This argument is inapposite, however, to the facts of the instant case.

Both §222 of the New York Surrogate's Court Act and Treas.Reg. §20.2053-3, like most state laws concerning executors and administrators, require an administrative expense to be "necessary" in order to be allowable. See 31 Am.Jur.2d Executors and Administrators §§524, 527 (1967); In re Rosenberg's Estate, 169 Misc. 92, 6 N.Y.S.2d 1009, 1012-1013 (Sur.Ct.1938). Normally, therefore, a Surrogate's court decree approving expenditures by an executor as proper administrative expenses under New York law will be controlling and will not raise questions concerning possible discrepancies between §2053 of the Internal Revenue Code of 1954 and Treas.Reg. §20.2053-3(d)(2). *See* Treas.Reg. §20.2053-1(b)(2) ("The decision of a local court as to the amount and allowability under local law of a claim or administration expense will ordinarily be accepted if the court passes upon the facts upon which deductibility depends."); Dulles v. Johnson, 273 F.2d 362 (2 Cir. 1959), cert. den., 364 U.S. 834, 81 S.Ct. 54, 5 L.Ed.2d 60 (1960); Sussman v. United States, 236 F.Supp. 507 (E.D.N.Y. 1962).

As noted in Pitner v. United States, 388 F.2d 651, 659 (5 Cir. 1967), however, the interest of the federal government in taxing the passage of property from a decedent's estate to individual beneficiaries or to a trustee will not always completely or accurately be reflected in a state's interests in supervising the fiduciary responsibilities of executors. In the present case, appellants' claims for administration expenses were not contested in the Surrogate's Court and there is some question as to whether some of these expenses were in fact incurred for the benefit of the estate in accordance with the general purpose of §2053 rather than for the benefit of individual beneficiaries. *See* Commercial Nat. Bank of Charlotte v. United States, 196 F.2d 182, 183-184 (4 Cir. 1952); *Cf.* United States v. Stapf, 375 U.S. 118, 130-131, 84 S.Ct. 248, 11 L.Ed.2d 195 (1963), reh. den., 375 U.S. 981, 84 S.Ct. 477, 11 L.Ed.2d 428 (1964). In such circumstances, the federal courts cannot be precluded from re-examining a lower state court's allowance of administration expenses[4] to determine whether they were in fact necessary

4. Such administrative expenses must be the "type intended to be deductible" (United States v. Stapf, 375 U.S. 118, 130, 84 S.Ct. 248, 11 L.Ed.2d 195 (1964)), ultimately a question of federal law. See Pitner v. United States, 388 F.2d 651 (5 Cir. 1967). The holding in *Pitner* differs from the interpretation placed upon it by Judge Mulligan in his dissent. The court in that case assumed that the expense deduction was allowable by the laws of the jurisdiction under which the estate was being administered, and yet held that

> "[i]n the determination of deductibility under section 2053(a)(2), it is not enough that the deduction be allowable under state law. It is necessary as well that the deduction be for an 'administration expense' within the meaning of that term as it is used in the statute, and that the amount sought to be deducted be reasonable under the circumstances. These are both questions of federal law and establish the outside limits for what may be considered allowable deductions under section 2053(a)(2)." 388 F.2d at 659.

Thus, the Fifth Circuit, as well as the Tax Court, have rejected the proposition that the only requirement for deductibility under Section 2053(a) is the allowability of the expense under state law.

to carry out the administration of the estate or merely prudent or advisable in preserving the interests of the beneficiaries. *Cf.* Commissioner v. Estate of Bosch, 387 U.S. 456, 87 S.Ct. 1776, 18 L.Ed.2d 886 (1967); Commercial Nat. Bank of Charlotte v. United States, 196 F.2d 182, 185 (4 Cir. 1952); Treas.Reg. §20.2053-1(b)(2). Viewed from this standpoint, the Tax Court's determination that the additional sales of sculpture were not necessary to preserve the estate or to effect its distribution did not involve a refusal to follow New York law, but rather was the result of a *de novo* inquiry into the factual necessity for these expenditures.

It is, therefore, unnecessary to pass on whether Treas. Reg. §20.2053-3(d)(2) is invalid if read to deny a deduction properly allowed by state law. As the determination of the Tax Court is not clearly erroneous, it is affirmed.

MULLIGAN, Circuit Judge (dissenting):

I dissent with respect but without reluctance. Section 2053(a) of the Internal Revenue Code provides that in determining a decedent's taxable estate there shall be a deduction from the gross estate of

> such amounts . . . for administration expenses . . . as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

The estate here was administered in the State of New York and the selling commissions at issue here were held to be allowable as proper expenses by the Surrogate of Warren County in several separate accountings. The Code unam-

biguously provides for their deduction if allowed by the jurisdiction administering the estate and neither the Commissioner of Internal Revenue nor the Tax Court, in my view, can properly reverse the State Court determination. Congress has explicitly left the matter in the hands of the state.

In a case squarely in point, the Sixth Circuit reversed the Tax Court's denial of deductibility, stating:

> By the literal language of §2053(a), Congress has left the deductibility of administrative expenses to be governed by their chargeability against the assets of the estate under state law. As otherwise stated, Congress has committed to the considered judgment of the states whether a particular expense is allowable as a proper or necessary charge against estate assets. In the situation before us, the expenses were admittedly allowable under Michigan law. They were paid out of probate assets and they were approved in two different accountings filed with the probate court. Hence they are deductible under §2053(a).

Estate of Park v. Commissioner, 475 F.2d 673, 676 (6th Cir. 1973). *Park* is not alone in holding that the plain meaning of the statute controls and that the Congress intended deductibility to be determined by state law. E. g., Ballance v. United States, 347 F.2d 419, 423 (7th Cir. 1965); Commercial National Bank v. United States, 196 F.2d 182, 185 (4th Cir. 1952); Estate of Louis Sternberger, 18 T.C. 836, 843 (1952), aff'd, 207 F.2d 600 (2d Cir. 1953), rev'd on other grounds, 348 U.S. 187, 75 S.Ct. 229, 99 L.Ed. 246 (1955); see Dulles v. Johnson, 273 F.2d 362, 369-370 (2d

Cir. 1959), cert. denied, 364 U.S. 834, 81 S.Ct. 54, 5 L.Ed.2d 60 (1960).

The majority opinion not only ignores *Park* but the Code as well, focusing instead upon Treasury Regulation §20.-2053-3(d)(2), which provides deductions from gross estates for selling expenses "if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." As the majority opinion points out, §222 of the New York Surrogate's Court Act, which was then in effect, similarly provided for the deduction of administration expenses "necessarily" incurred. The majority opines that the state's interest in supervising the fiduciary responsibilities of its executors may not always be compatible with the interest of the federal government in collecting taxes. The obvious answer is that in §2053(a) of the Code, the Congress decided without any limitation that the state law controlled. If the Regulation by adding the word "necessary" gives the Commissioner of Internal Revenue the authority to review the determination of the New York State Surrogate and interpret what is "necessary" solely from the point of view of the federal taxing power, then the Regulation conflicts with the Code, is contrary to the intent of Congress, and is therefore invalid. E. g., United States v. Calamaro, 354 U.S. 351, 359, 77 S.Ct. 1138, 1 L.Ed.2d 1394 (1957); Dorfman v. Commissioner, 394 F.2d 651, 655 (2d Cir. 1968).

The majority here states that the Tax Court was not refusing to follow New York law but rather was making a *de novo* inquiry into the question of the factual necessity of these expenditures, and thus it is "unnecessary to pass on" the argument that the Regulation conflicts with the Code. I

cannot agree that the issue can be so circumvented. The laws of the state are interpreted and administered by the courts of the state and not by the Tax Court of the United States. Pitner v. United States, 388 F.2d 651 (5th Cir. 1967), relied upon by the majority, is totally unlike the case before us. There had been no formal probate of the decedent's estate in that case and no Texas court had made any ruling which would bind the Tax Court. The Tax Court found no Texas statute or case in point, hence the necessary reliance on federal law.[1]

The functioning of the I.R.S. or the Tax Court as a surrogate Surrogate is particularly unfortunate here.

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1. The other cases cited in the majority opinion are either distinguishable or in fact helpful to the appellant. Commissioner v. Estate of Bosch, 387 U.S. 456, 87 S.Ct. 1776, 18 L.Ed.2d 886 (1967) involved the question of whether a federal court or agency in a federal tax controversy is conclusively bound by a state trial court adjudication regarding the characterization of property interests. There was no act of Congress there ceding jurisdiction to the state but only the report of a Senate Committee recommending that "proper regard," not finality, should be given to the interpretation of a will by state courts. Id. at 464, 87 S.Ct. 1776. Commercial Nat'l Bank v. United States, *supra*, did deal with the question of whether attorneys' fees were administrative expenses under the old Internal Revenue Code but found that the state court had never passed upon the question since the fees were fixed by stipulation between the parties and the issue was intentionally excluded from the judgment of the state court. The position of the United States, namely, that even if the fees had been assessed by the state court they were not deductible for federal tax purposes, was therefore not reached but in dicta was described by the court as "doubtful." The court cited Lyeth v. Hoey, 305 U.S. 188, 194, 59 S.Ct. 155, 158, 83 L.Ed. 119 (1938) for the proposition that it is the will of Congress which controls in interpreting a tax statute. "Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law." I submit that this was the case here.

Dulles v. Johnson, *supra*, and Sussman v. United States, 236 F. Supp. 507 (E.D.N.Y. 1962) both followed the state court's determination of administration-expense deductions.

While the commissions paid were substantial, we must bear in mind that the artist had difficulty in selling his works while alive and, two years before he died, of necessity entered into a 33⅓% commission arrangement with a gallery for a five-year period. During the last 25 years of his life he had sold only 75 pieces of his sculpture and died owning 425 pieces, 185 of which were more than seven feet high. *Ars longa, vita brevis.* This art work represented approximately 93% of the value of his total estate. Smith was an abstract non-representational sculptor who worked with steel and other metals, and his works required substantial space for proper exhibition. Faced with an estate so constituted and recognizing the necessity of liquidation to satisfy estate taxes which could not be determined with any degree of certainty in view of the unpredictable and volatile nature of artistic tastes and fashions, the fiduciaries liquidated some of the sculptures in the estate. The determination below that they were improvident in disposing of the sculptures or that it was done for the benefit of the beneficiaries rather than the estate is made only with the infallible acuity of hindsight. The behavior of testamentary fiduciaries is more appropriately gauged by the surrogate rather than by federal tax authorities.

Since I believe there was a failure to recognize the command of the Code, I would characterize the error here as one of law and not of fact, which would make the "clearly erroneous" test set by the majority inapplicable. Trust of Bingham v. Commissioner, 325 U.S. 365, 371, 65 S.Ct. 1232, 89 L.Ed. 1670 (1945). The five dissenting tax court judges were, in my view, correct in finding that the determination of the New York Surrogate as to deductibility was binding.

APPENDIX C

The Statute and Regulations Involved in the Case

Internal Revenue Code of 1954 (Title 26 U.S.C.)

Section 2053. EXPENSES, INDEBTEDNESS, AND TAXES

(a) GENERAL RULE.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

Treasury Regulations

§20.2053-3 **Deduction for expenses of administering estate**—(a) *In general.* The amounts deductible from a decedent's gross estate as "administration expenses" of the first category (see paragraphs (a) and (c) of §20.2053-1) are limited to such expenses as are actually and necessarily

incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions; (2) attorney's fees; and (3) miscellaneous expenses. Each of these classes is considered separately in paragraphs (b) through (d) of this section.

(b) *Executor's commissions.* * * *

(c) *Attorney's fees.* * * *

(d) *Miscellaneous administration expenses.* (1) Miscellaneous administration expenses include such expenses as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in preserving and distributing the estate are deductible, including the cost of storing or maintaining property of the estate, if it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may not include outlays for additions or improvements; nor will such expenses be allowed for a longer period than the executor is reasonably required to retain the property.

(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale, such as the fees of an auctioneer if it is reasonably necessary to employ one. Where an item included in the gross estate is disposed of in a bona fide sale (including a redemption) to a dealer in such items at a price below its fair market value, for purposes of this paragraph there shall be treated as an expense for selling the item whichever of the following amounts is the lesser: (i) the amount by which the fair market value of the property on the applicable valuation date exceeds the proceeds of the sale, or (ii) the amount by which the fair market value of the property on the date of the sales exceeds the proceeds of the sale. The principles used in determining the value at which an item of property is included in the gross estate shall be followed in arriving at the fair market value of the property for purposes of this paragraph.

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1387

IRA M. LOWE, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole question raised by the petition is whether certain expenses of sale incurred by an estate were deductible for estate tax purposes under Section 2053(a) of the Internal Revenue Code of 1954.

Petitioners were co-executors of the estate of David Smith and also co-trustees of the testamentary trusts established by Smith's will for the benefit of his children. On May 23, 1965, Smith, a sculptor, died owning 425 pieces of sculpture which he had created. From the date of Smith's death until his estate was closed on August 21, 1973, petitioners sold a substantial amount of these sculptures and incurred selling expenses of $1,583,544.67. These expenses were approved by the

New York Surrogate's Court in an uncontested proceeding and petitioners deducted them in computing their federal estate tax liability as expenses of administration under Section 2053(a) of the Code.

Pursuant to Treasury Regulations, Section 20.2053-3 (d)(2), the Commissioner allowed a $750,447.74 deduction for the sales expenses incurred by petitioners, limiting the deduction to those sales that were necessary to raise enough cash to pay debts, other administration expenses, and taxes of the estate (Pet. App. B 32a-33a). The Tax Court upheld the Commissioner's determination. It found that the decedent's will "itself contemplated a distribution of the sculptures in kind to the trusts for the benefit of [his] daughters" (Pet. App. A 20a). Since neither the decedent nor his estate was under any obligation to support the daughters after the decedent's death, the Tax Court further found (*ibid.*) that to the extent that petitioners sold the sculptures placed in the daughters' trusts, "they were acting on behalf of the trust and not on behalf of the estate." It therefore held that the excess of petitioners' expenses of sale over $750,447.74 was incurred with respect to additional sales of sculpture which were not necessary either to preserve the estate or to effect distribution, but were made on behalf of the testamentary trusts (Pet. App. A 18a-22a).[1] A divided court of appeals affirmed (Pet. App. B 31a-41a).

1. The decision below correctly held that the expenses of sale were deductible only to the extent that they were related to the administration of the estate and not to the testamentary trusts. Section 2053(a) of the Code allows an estate tax deduction for "administration expenses * * * as are allowable by the laws of the juris-

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[1]During the period May 23, 1965, to April 30, 1970, petitioners distributed $1,448,429.44 in cash from the estate to the beneficiaries, the testamentary trusts and Smith's children (Pet. App. A 9a).

diction * * * under which the estate is being administered." Section 20.2053-3(a) of the Treasury Regulations defines the statutory term "administration expenses" as "limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate * * *."

More specifically, Section 20.2053-3(d)(2) of the Treasury Regulations provides that expenses of sale are deductible only to the extent the sale is "necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." The Regulation is "prima facie proper, comporting as * * * [it does] with the ordinary understanding" of the term "administrative expenses." *Bingler* v. *Johnson*, 394 U.S. 741, 749, 751. See also *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. Moreover, the Regulation has been in effect in substantially identical language since 1919[2] and is thereby "deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill*, 305 U.S. 79, 83.

Contrary to petitioners' argument (Pet. 7-11), Section 2053(a) does not make allowance of an expense by the local probate court the sole criterion of deductibility. Of course, the allowability of an expense under state law is relevant in determining deductibility under Section 2053(a). But to be deductible for estate tax purposes, an expense must be of the "type intended to be deductible," which is ultimately a question of federal law. *United States* v. *Stapf*, 375 U.S. 118, 130. See also *Pitner* v. *United States*, 388 F.2d 651, 659 (C.A. 5); *Ballance* v. *United States*, 347 F.2d 419, 422 (C.A. 7).[3]

[2]See Treasury Regulations 37, Arts. 41, 44, promulgated under the Revenue Act of 1918.

[3]Petitioners argue (Pet. 10, 13) that *Ballance* v. *United States*, *supra*, supports their contention that state law controls the deductibility of estate administration expenses. Quite the contrary is the case. In holding that the taxpayer was not entitled to a deduction for administration expenses for interest paid on delayed federal estate tax

Pursuant to the Treasury Regulations, a deductible expense of estate administration is one which furthers the settlement of a decedent's estate, as distinguished from the expenses of administering other entities such as the testamentary trusts involved in this case. "[T]he carrying on of the trust is * * * for the benefit of the beneficiaries of the trust. It operates to continue the affairs of the living, not to close up those of the departed." *Sharpe's Estate* v. *Commissioner*, 148 F.2d 179, 181 (C.A. 3).

Thus, for example, in *Estate of Peckham* v. *Commissioner*, 19 B.T.A. 1020, the Board of Tax Appeals refused to allow any deduction for the expenses of maintaining and preserving the estate beyond the ordinary period of administration—in that case three years—because it found that after such time the executors were in fact holding the assets as trustees. Similarly, here, where part of the expenses were found to be attributable to the administration of the testamentary trusts and not to the administration of the estate, the decision below correctly disallowed the deductibility of that portion relating to the testamentary trusts. The expenses in question were not "administration expenses" of the estate within the meaning of the predecessor of Section 2053(a).

2. Petitioners argue (Pet. 11-14) that the decision below conflicts with *Estate of Park* v. *Commissioner*, 475 F.2d 673 (C.A. 6). There, an estate claimed a deduction under Section 2053(a) for expenses of selling real estate which had passed to the decedent's children under the residuary clause of her will. The children determined that they were not interested in retaining the properties and requested the executor to sell them. Relying on Treasury Regulations, Section 20.2053-3(d), the Tax Court (57 T.C. 705) concluded that the expenses in question were not deductible because the sale of the real estate was for the sole benefit of the beneficiaries and not to preserve the estate or effect distribution.

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payments, the Seventh Circuit rejected the view that state law controls. It noted (347 F.2d at 422) that the federal estate tax itself, while an allowable administration expense under Illinois law, was clearly not deductible under the predecessor of Section 2053(a).

The Sixth Circuit reversed. It held that the fact that Michigan law allowed the expenses to be charged against the probate assets governed their deductibility for federal estate tax purposes under Section 2053(a). In so concluding, the court invalidated Treasury Regulations, Section 20.2053-3(d), which provides that expenses of sale are deductible only to the extent the sale is "necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." Moreover, the court in *Park* noted that the executor's decision to sell the real estate could be viewed as benefiting the estate regardless of the wishes of the beneficiaries.

Unlike *Park*, however, the decision below did not reach the question of the validity of the Regulation. The court of appeals noted (Pet. App. B 35a) that both Section 222 of the New York Surrogate's Court Act and Treasury Regulations, Section 20.2053-3, require an administrative expense to be "necessary" to the estate in order to be allowable. Moreover, like the Treasury Regulation, New York law characterizes the expenses in question as trust administration expenses rather than estate administration expenses.[4] See *Hurlburt* v. *Durant*, 88 N.Y. 121; *Johnson* v. *Lawrence*, 95 N.Y. 154; I Scott, *Law of Trusts* §6, p. 58 and n. 5 (3d ed., 1967). Finally, the fact that the decedent's will contemplated a distribution of the sculpture in kind to the daughters' trusts demonstrates that petitioners' sales of these items were done on behalf of the trusts and in their capacity as trustees and not as executors.

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[4]The fact that the New York Surrogate's Court allowed the sales expenses in an uncontested accounting is not determinative for purposes of deductibility under Section 2053(a). The surrogate did not characterize these expenses as estate administration expenses but simply allowed their payment by petitioners (Pet. App. A 8a). Indeed, even with respect to trust expenses, New York law required the surrogate to approve the accounts in order to insure that petitioners' actions were lawful in their capacity as trustees. See *Matter of McDowell*, 178 App. Div. 243, 164 N.Y.S. 1024; *Matter of Robinson*, 155 Misc. 855 (N.Y. Sur. Ct), 280 N.Y.S. 687. Thus, the surrogate's allowance cannot be regarded as a determination under state law for purposes of Sec-

Thus, this case does not present the purported conflict between state law and the Regulations which the Sixth Circuit perceived in *Park* and resolved in favor of state law. While *Park* concluded that "the expenses were admittedly allowable under Michigan law" (475 F.2d at 676), petitioners did not, and could not, demonstrate that the uncontested expenses approved by the surrogate were allowable as estate administration expenses rather than as trust administration expenses under New York law. As the court of appeals observed (Pet. App. B 37a), it was "unnecessary [for it] to pass on whether Treas. Reg. §20.2053-3(d)(2) is invalid if read to deny a deduction properly allowed by state law."[5]

Contrary to petitioners' assertion (Pet. 10), there is no conflict with *Union Commerce Bank* v. *Commissioner*, 339 F.2d 163 (C.A. 6). That case dealt with the deductibility as an administrative expense of post-death interest on overdue gift tax obligations. The court did not regard as dispositive the fact that such an expense is not covered in Treasury Regulations, Section 20.2053-3, but relied upon Ohio law and remanded the case to the Tax Court for additional evidence as to how the expense was treated by the local probate court (339 F.2d at 167-168). However, the apparent allowance of such an expense under Ohio law, coupled with the silence of the Treasury Regulations, effectively distinguishes that case from the decision below, where both the state law and the Treasury Regulations characterized the expense in question as not incurred on behalf of the estate.

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tion 2053(a). Moreover, where a portion of these expenses were incurred on behalf of the testamentary trusts and not the estate, the federal courts are not precluded from reexamining a lower state court's allowance of administration expenses. See *Commissioner* v. *Estate of Bosch*, 387 U.S. 456. Treasury Regulations, Section 20.2053-1(b)(2).

[5]Petitioners' reliance (Pet. 10, 13) upon *Commercial Nat. Bank of Charlotte* v. *United States*, 196 F.2d 182 (C.A. 4), is similarly misplaced. Like the decision below, the court did not find it necessary to decide the question whether the allowability of an administrative expense under state law was determinative for federal estate tax purposes because the costs involved were not allowable under state law.

Finally, the decision below does not conflict with *Dulles* v. *Johnson*, 273 F.2d 362 (C.A. 2) (Pet. 11). There, the court permitted deductions as administration expenses of fees paid by the estate to lawyers who represented various legatees in estate litigation commenced by the executors in state courts. The litigation involved the questions whether a charitable beneficiary was a functioning organization and whether estate taxes were to be paid prior to the establishment of a residuary estate. Pursuant to orders of the New York appellate courts and the New York Surrogate's Court, the estate paid the legal fees of all of the parties.

Unlike this case, where the estate's claim to a deduction rests upon an uncontested allowance by the probate court of expenses which were properly classifiable under New York law as trust expenses, the court in *Dulles* found that the legal fees were paid "pursuant to a court order required as a direct and unavoidable result of the proceedings instigated by [the executors] to construe the will they were to administer" (273 F.2d at 369-370). As such, they were deductible administration expenses under Section 2053(a), since they were "attorney's fees" "essential to the proper settlement of the estate * * *." Treasury Regulations, Section 20.2053-3(a).

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JULY 1975.